THE BANKING ASSOCIATION SOUTH AFRICA

Financial Sector Law Amendment Bill

NCOP Select Committee on Finance

BASA concerns raised to SCoF

"The financial sector laws amendment bill repeals section 69 of the Banks Act in its entirety, replacing it with the "orderly resolution of a designated institution" by a "resolution practitioner". The amendments to section 83.10 of the Insolvency Act relating to master agreement pledged assets upon the occurrence of a South African bank bankruptcy, would now apply to the proposed "resolution" as well. With the removal of section 69 of the Banks Act, that cured the right of access for a beneficiary, the situation has been reversed and no protection will be afforded under the new legislation. **Section 69 of the Banks Act and section 83.10 together provide the necessary legal certainty**."

Follow on Discussions prior to SCoF

- Concerns have been raised that a couple of important aspects of the "**contractual stay**" provisions in the FSLAB were inconsistent with the corresponding laws published in other international leading jurisdictions and are therefore not consistent with the current international market standard
- The draft resolution regime provides in section 166L of the Bill that placing a designated institution into resolution is not an acceleration or termination event and section 166G of the Bill provides that placing a designated institution into resolution is also not an act of insolvency for the purposes of the Insolvency Act.
- Therefore a counterparty cannot early terminate a transaction under an ISDA agreement and would therefore not be able enforce its rights under a collateral pledge, to the extent that a SA bank is placed into resolution.
- This in itself is not problematic, but unlike the BRRD there is no concept here of a **resolution weekend** – there is an outright freeze on early termination for an unspecified time.
- The only protection that is currently provided to collateral in derivative transactions is to carve out the powers of the SARB (as the resolution authority) from reducing amounts owing under a derivative transaction or cancelling the derivative transaction agreement.
- This will impact the opinion of foreign jurisdictions if South Africa is a collateral netting "friendly/green" jurisdiction

Proposals made to National Treasury

- Discussions were held with National Treasury, SARB, The International Swaps and Derivatives Association (ISDA) and Allen & Overy LLP (A&O)
- We set out an overview of the concerns raised during the discussions as well as recommendations that were not necessary for South Africa to retain a "green" international netting status but also, provide a stronger resolution framework and enhance the Regulator's rights in a resolution scenario
- We remain confident that National Treasury will resolve this matter prior to the promulgation of the FSLAB into law

Drafting oversight FSLAB / FSRA?

FSLAB proposes the introduction of sections 166S(7) and (9) of the Financial Sector Regulation Act 2017 ("FSRA").

Section 166S(7) grants the Reserve Bank resolution powers ("**Resolution Powers**") to reduce the amount payable under an agreement (section 166S(7)(a)) or cancel an agreement (section 166S(7)(b)) in the circumstances set out in the sections.

Section 166S(9) carves outs the following agreements transactions from the Resolution Powers:

a) an unsettled exchange traded transaction;
b) a derivative instrument (as defined in the Financial Markets Act 2012 ("FMA"));
c) a deposit where the deposit holder is the Corporation for Public Deposits;
d) an unsecured transaction between two or more settlement system participants as defined in the National Payment System Act.

On our reading of these sections, the above carve outs do not cover securities lending and repurchase agreements ("**Prime Finance Agreements**") as such agreements clearly do not fall within carve outs (a), (c) and (d).

We also believe that Prime Finance Agreements do not fall within the definition of a "derivative instrument" in the FMA (carve out (b)).

This is because the rights and obligations arising under Prime Finance Agreements do not depend on the value of underlying assets, rates, indices or measures of economic value or a default event.

- Rather, Prime Finance Agreements document shadow banking products which are not considered to be derivative instruments by the market or the regulators both on a global and a local basis.

- This means that transactions under Prime Finance Agreements effectively become subject to the Resolution Powers and can be amended or cancelled by the Reserve Bank.

- Section 68(6B) of the current Banks Act 1990 specifically provides that section 35B of the Insolvency Act, 1936 ("**Insolvency Act**") applies to the curator of a bank under curatorship

- Section 35B(2) of the Insolvency Act provides for the netting of a "master agreement" which is broadly defined in section 35B(2) as :

  > "an agreement in accordance with standard terms published by the International Swaps and Derivatives Association, the International Securities Lenders Association, the Bond Market Association or the International Securities Market Association, or any similar agreement, which provides that, upon the sequestration of one of the parties all unperformed obligations of the parties in terms of the agreement" can be netted."

- The effect of this would be that such transactions effectively lose the post insolvency benefits enshrined in section 35B of the Insolvency Act as there is no similar treatment afforded for Prime Finance Agreement under FSLAB and South Africa would therefore lose its global netting status for these types of agreements.

- The legislators and regulators both in South Africa and globally have been working tirelessly to implement best practice recommendations in order to promote financial market stability and prevent systemic risk to the financial system.
- In this regard, certainty of early close out of financial market transactions and the ability to net such transactions are cornerstones designed to achieve that.
- Accordingly, we do not believe we differ substantively on the point and that the issue relates to the how section 166S(9) is worded.

- We believe that section 166S(9) can simply be clarified as follows:

"166S(9) Subsection (7) does not apply to the following:

a) an unsettled exchange traded transaction, including a transaction on a licenced exchange;
b) a transaction~~derivative instrument~~ under a 'master agreement" as defined in section 35B(2) of the Insolvency Act (Act No. 24 of 1936); ~~section 1 of the Financial Markets Act;~~
c) a deposit where the deposit holder is the Corporation for Public Deposits established by section 2 of the Corporation for Public Deposits Act, 1984 (Act No. 46 of 1984);
d) an unsecured transaction between two or more settlement system participants as defined in section 1 of the National Payment System Act, made for the purposes of that Act."